



SECTION - 2

CONCEPT AND NATURE OF LEVERAGES

This Section includes

- The basic concept of Leverage
- Use of Leverages in Finance

2.1 THE BASIC CONCEPT OF LEVERAGE

- 2.1.1 The concept of leverage has its origins in Science, more specifically in Physics. Let us recall how the simple crowbar was used to illustrate a fundamental, but eminently useful concept.
- 2.1.2 Consider the example of a young boy using a pole to move a heavy stone. He places one end of the pole under the edge of the stone. He supports the pole on a brick placed close to the stone. He pushes downwards at the other end of the pole. This helps him move the stone easily.
- 2.1.3 The pole that the boy uses is a **lever**. The downward force he applies at one end of the pole is called the effort and the stone he lifts is referred to as the load. The pole was supported at the point of resting on the brick called fulcrum. By using a small effort the boy was able to lift a large load.
- 2.1.4 Thus, a lever is a simple machine that makes it easier to move a load.

2.2 USE OF LEVERAGES IN FINANCE

- 2.2.1 In financial management we shall discuss two important types of leverages, referred to as Operating Leverage and Financial Leverage, arising out of the fixed costs in an organization's cost structure.